

LESSON

3

FROM W-4 TO 1040A

Revised November, 1999

Note: This lesson is designed to be taught over a three-to-five-day period. It is presented in three parts. Each of these parts can be taught in one day, but they will require more time if the software component is used to give students further practice in using tax forms.

PURPOSE

This lesson is to help students understand that: (1) they must pay tax, when their income goes over a certain amount; (2) taxpayers are responsible for paying income taxes through withholding as they earn income; (3) they voluntarily report their income to the government by filing a tax return; and (4) there are specific forms to help taxpayers in different situations do this. This three-part lesson will acquaint students with the basic tax-related forms they are likely to encounter.

OBJECTIVES

After participating in the suggested activities, students will be able to:

- discuss the use and importance of Forms W-4, W-2, 1040EZ, and 1040A
- determine, when given enough information, whether an individual must file a return
- identify the return form that is most appropriate for certain taxpayers
- define and use relevant concepts and terms in order to fill out Forms W-4, 1040EZ, and 1040A correctly.

MATERIALS

- Student Handout 3.1, "Glossary of Key Terms"
- Student Handout 3.2, "Form W-4"
- Student Handout 3.3, "Are You Exempt from Withholding?"
- Student Handout 3.4, "The Dependency Tests"
- Student Handout 3.5, "Examples"
- Student Handout 3.6, "Case Studies"
- Student Handout 3.7, "Form W-2 and Form 1099-INT"
- Student Handout 3.8, "Should You File a Tax Return?"
- Student Handout 3.9, "Which Tax Return Form Should You Use?"
- Student Handout 3.10, "Form 1040EZ" (used in Lesson 2)
- Student Handout 3.11, "Tax Table" (pages 1 and 2)
- Student Handout 3.12, "Form 1040EZ" Step-by-Step
- Student Handout 3.13, "Form 1040A" (pages 1 and 2)
- Student Handout 3.14, "Schedule 1"
- Student Handout 3.15, "Standard Deduction Worksheet for Dependents" (From Form 1040A Instructions)
- Student Handout 3.16, "Form 1040A Step-by-Step" (2 pages)
- Student Handout 3.17, "The Tax Maze"
- Student Handout 3.18, "Lesson Summary" (2 pages)
- Student Handout 3.19, "Answers - The Tax Maze"

UNDERSTANDING Tax Forms

To get the most up-to-date tax products and information visit our world wide website at: **www.irs.ustreas.gov**

KEY TERMS

Ability to Pay

A concept of tax fairness that people with different amounts of wealth or different amounts of income should pay tax at different rates. Wealth includes assets and property, such as houses, cars, stocks, bonds, and savings accounts. Income includes wages, interest, and dividends.

Adjusted Gross Income

Total income reduced by certain deductions, such as for an IRA or student loan interest.

Credits

A direct reduction of tax owed. Credits are allowed for such purposes as child care, higher education costs, qualifying children, and the earned income credit for low-income taxpayers.

Dependent

A person who relies on someone else for support. A taxpayer may claim an exemption for a dependent if certain conditions (dependency tests) are met. Taxpayers cannot claim themselves or their spouses as dependents.

Dividends

A corporation's distributions to its shareholders from its earnings and profits.

Earned Income

Includes wages, salaries, tips, net earnings from self-employment, and other income received for personal services.

Earned Income Credit

A credit that can be paid to low-income workers, even if no income tax was withheld from the worker's pay. To receive the credit, a qualified taxpayer must file a tax return.

e-file

Filing a return by computer. The information is transmitted over telephone lines to an IRS computer where it is automatically checked and processed. Refunds can go into the taxpayer's savings or checking account by Direct Deposit.

Exempt (from Withholding)

Free from withholding of federal income tax. Must meet certain income, tax liability, and dependency criteria. Does not exempt a person from other kinds of tax withholding, such as social security tax.

Exemption (Personal or Dependency)

Amount that taxpayers can claim for themselves, their spouses, and eligible dependents. The total is subtracted from adjusted gross income before tax is figured on the remaining income.

Federal/State e-file

Program, sponsored by IRS in partnership with participating states that allows taxpayers to file federal and state income tax returns electronically at the same time.

Gross Income

Money, goods, and property you received that must generally be reported on a tax return and may be included in taxable income.

Interest Income

Income a person receives from certain bank accounts or from lending money to someone else.

Standard Deduction

An amount provided by law and based on filing status, age, blindness and dependency that taxpayers may deduct from their adjusted gross income before tax is determined.

Tax Withholding

Money that an employer holds back from an employee's pay to pay part or all of the employee's taxes.

Taxable Income

The income on which tax is figured.

TeleFile

Filing returns over touch-tone phone. The taxpayer must receive a Tele-File package by mail and qualify to use Forms 1040EZ.

1040PC

A condensed paper tax return prepared on a personal computer using IRS-accepted tax preparation software, plain paper, and a printer. The return is mailed. Refunds go into the taxpayer's savings or checking account by Direct Deposit.

Unearned Income

Income other than pay for work performed. Interest and dividends from savings or investments are common kinds of unearned income.

Withholding Allowance

Claimed by an employee on Form W-4. An employer uses the number of allowances claimed, together with income earned and marital status, to determine how much income tax to withhold from wages.

Opening the Lesson:

Voluntary Compliance, Pay-As-You-Go, and Tax Withholding

Distribute copies of Student Handout 3.1, "Glossary of Key Terms"

The following discussion is designed to clarify three main concepts that lie behind the use of the forms discussed in this lesson. Other lessons touch on these concepts, but it is important for students to understand them here.

Permit a minute or so of debate of the question. Then elicit, if possible, or explain the concept of "voluntary compliance."

Ask, "Do you have to file a tax return and pay taxes?"

The U.S. income tax system is built on the idea of "voluntary compliance." This means that it is left to the taxpayer to keep the necessary records, file a return on time, pay any required taxes, and meet other requirements of the tax law. The system is built on trust in citizens to know their responsibilities and to do what needs to be done. Taxpayers voluntarily follow the steps the tax system lays out. Not doing so can result in penalties.

Elicit, if possible, or explain the concept of "pay-as-you-go" or "tax withholding."

Ask, "How do most taxpayers pay their income taxes?"

Most people's income comes from salary or wages earned in a job. In the "pay-as-you-go" method of tax payment, a taxpayer must pay the tax as income is earned or received during the year. For example, an employer withholds tax based on wages paid and information the employee provides on Form W-4. This system is called "tax withholding."

Elicit or explain the advantage for taxpayers of not being "hit" with a sudden tax bill and the Government's need for uninterrupted revenues.

Ask, "What is the advantage of withholding for taxpayers? For the Government?"

Without tax withholding many people would find it difficult to save enough money to pay their income taxes all at once. Government services might be disrupted and undependable if they were not funded on a continuous basis.

Developing the Lesson

Activity 1—Filling Out a Form W-4

Distribute copies of Student Handout 3.2, "Form W-4" or use an overhead projector to display it. If you haven't previously distributed Student Handout 3.1, "Glossary of Key Terms," do so now.

Have the students look over the form.

They should notice that on the front there are directions and two parts and on the back two parts and a table.

Ask whether any of the students has filled out a Form W-4. Ask one of them who responded positively, "What did you do with it after you filled it out?"

The bottom part is cut off and given to the employer (or the personnel officer, etc.).

Form W-4 used in this lesson is for 1999. Form W-4 for 2000 should be available starting in late November 1999.

Ask, “Why does an employer need this form from each employee?”

The form helps the employer figure how much to withhold from the employee’s paycheck.

Ask, “What is the rest of the form for?”

The other parts are instructions and worksheets. The worksheets help you figure out how to fill in the part of the form you give to your employer.

Tell the students that the Form W-4 is used by all employees, including some whose tax situations are very complex. Most taxpayers will not need to use all parts of each worksheet.

Oversee the students as they fill out the distributed copies of the W-4 forms, or demonstrate how to fill one out if you are projecting it on an overhead, using the following steps.

Have the students fill in lines 1 and 2.

Ask, “What could happen if you write your social security number incorrectly, use a name other than the name on your Social Security card, or make a mistake on your address?”

Errors and inaccuracies might delay or prevent a tax refund and you may not receive proper credit for social security taxes you paid.

Ask, “If you don’t have a Social Security Number (SSN), where can you get one?”

You apply for one by filing Form SS-5 with the Social Security Administration (SSA) office (check the local phone book) for the address.

Have the students look at line 7.

Ask, “Who can explain the phrase, ‘exempt from withholding’?”

People who are “exempt from withholding” don’t need to have federal income tax taken out of their paychecks, usually because they earned very little income.

Encourage discussion.

Ask, “How do you know whether you are ‘exempt from withholding’?”

Distribute copies of Student Handout 3.3, "Are You Exempt from Withholding?"

Have a volunteer read the two bulleted sentences following line 7 on Form W-4. Have the class look at the diagram on Student Handout 3.3 and compare the rules for dependents and other people.

Distribute Student Handout 3.4, "The Dependency Tests."

Ask, "Who can be claimed as a dependent?"
Students are likely to respond that dependents are usually underage children.

Have the students look at "Test 1: Relationship or Member of Household Test" on the handout.

Ask, "How many of these dependents described are not underage or not the taxpayer's child?"
Students should conclude that many relatives and even non-relatives can be dependents.

Quickly review the other tests for dependency status: joint return; citizenship or resident; gross income (including student status); support. You may want to pause over Test 2, gross income, and discuss the dependency status of students.

A student dependent is the taxpayer's child who is under age 19 at the end of the tax year or under age 24 and a full-time student for some part of each of five months during the calendar year. The student must meet the other dependency tests except the gross income test.

Return to Student Handout 3.3 and line 7 on Form W-4.

Ask, "Suppose your parents plan to claim you as a dependent. Can you claim an exemption from withholding?"
If all the conditions on Student Handout 3.3 are met, the employee can enter "EXEMPT" at box 7 and sign and date Form W-4. Most employees will need to fill out the other lines.

Have the students look at line 5 of the Form W-4.

Ask a volunteer to read about "withholding allowance" from Student Handout 3.1, "Glossary of Key Terms."
Point out they will use withholding allowances to complete the Personal Allowances Worksheet in the upper part of the front of Form W-4.

Run through lines A through H quickly.

Ask students to fill out the worksheet as it applies to their own situation.
Some may have to review the definition of "dependent."

Explain that for some students the correct answer on line H will be zero.

Have the students enter the number from line H of the worksheet in box 5 of the certificate part of the Form W-4 unless they qualify for exemption from withholding.

Distribute Student Handout 3.5 Examples 1 and Example 2. Have the student look at Example 1.

Ask, “Why does Jay qualify as exempt from withholding?”

Notice that Jay does not need any of the lines on the Personal Allowance Worksheet.

Emphasize that an exemption claimed on Form W-4 is the federal income tax withholding only. Jay will still have withholding for social security tax and possibly other things.

Have the student look at Example 2.

Explain that employers have tables that tell them how much to withhold for married and single employees, and for employees with different salaries and withholding allowances. Taxes may be higher on the same income amount for a single person than for a married couple filing a joint return.

Call attention to line 6 (“Additional amount, if any, you want withheld from each paycheck.”)

Ask, “Why would anyone want to have extra deductions made from a paycheck?”

Some people may have income from other sources, such as interest or dividends. If more tax is withheld, more of their tax liability will be paid “as they go,” and they will not have to come up with a large lump-sum payment or possibly pay estimated taxes.

Point out that now Denise has a job. Jeffrey may want to file a new Form W-4 with his employers to change his withholding.

Ask, “What are the three ways Denise can have extra tax withheld?”

On line 3 she can check the box for “Married, but withholding at higher Single rate.” Her employer will withhold more tax than if she checks the box “Married.” This method works only for married people

Emphasize that tax withheld may not be equal to the total tax owed.

Be sure students understand the difference between claiming:

- **Zero withholding allowances: More tax will be withheld; and**
- **Exemption from withholding: No federal income tax will be withheld.**

Point out the worksheets on page 2 of Form W-4 and the second bullet under line H of the Personal Allowance Worksheet.

In the Personal Allowances Worksheet, and on line 5 of Form W-4, Denise can enter fewer allowances than she is entitled to take, down to zero. Each allowance a taxpayer claims authorizes the employer to withhold less tax. (There are penalties if a taxpayer claims too many allowances for his or her situation.) Both single and married people can use this method.

On Line 6, as shown, Denise can ask to have extra money withheld from each paycheck. Both single and married people can use this method.

Ask, “Can anyone tell why Denise used the Personal Allowance Worksheet and not the Two-Earned/Two Job Worksheet on the back of Form W-4?”

The Browns’ combined income for the year does not exceed \$55,000.

Emphasize that tax withheld may not be equal to the total tax owed.

Some people may have more withheld than they owe. They will get a refund when they file their returns. Other people may owe more tax than the amount withheld from their wages. They will have to send a payment with their return. Some may be subject to a penalty for underpayment of their taxes.

If time permits, distribute Student Handout 3.6 Case Students, and two fresh copies of Student Handout 3.2, Form W-4 to each student. Have the students do Case Study A.

Hint for the students: The instructions at the front and top of Form W-4, “Two Earners/Two Jobs” will help.

Ask, “Can you see why David does not need the Two-Earner/Two Job Worksheet?”

His combined earnings do not exceed \$32,000. See the second bullet under line H on the Personal Allowance Worksheet.

Ask, “How many allowances would David be entitled to claim on line 5 of Form W-4 if he had only the job with Employer A during the year?”

Two: one each from lines 1 and 2 of the Personal Allowances Worksheet. [correctly filled-out W-4, when new form is available]

Activity 2: Form W-2 and Form 1099-INT (5 minutes)

Distribute copies of Student Handout 3.7, "Form W-2 and Form 1099-INT"

Explain to the students that by law employers must give their employees a copy of Form W-2 by January 31 of each year. Employees with more than one employer should get one from each employer.

Point out the following boxes on Form W-2:

Box c: Name and address of the employer

Box e: Name and address of the employee

Box d: Employee's Social Security Number

Box 1: The employee's actual pay for the year from this employer

Box 2: The amount of federal income tax withheld.

Tell students that taxpayers must send Copy B of Form W-2 with their federal tax return. It is in their interest to double-check the information on their Form W-2 and to report any problems or mistakes to their employers right away.

Go back to Student Handout 3.1, Glossary of Key Terms. Have a student read the definition of "unearned income."

Point out Form 1099-INT on Student Handout 3.7 to the students. A bank or other financial institution sends this form to taxpayers who have "unearned income" to show how much interest income was earned. A copy is also sent to the IRS. Taxpayers must include unearned income in the total income they report on their return.

1 class period:

Optional

If any class time remains, you may have the students begin working on the first of the Case Studies (Student Handout 3.6) used in the Extending the Lesson section.

Filing a Return and Form 1040EZ

1. Deciding Whether To File

In this lesson students learn to complete a paper return. Returns can also be filed by computer (through e-file) or by TeleFile. (See Student Handout 3.1 - Glossary of Key Terms.)

Ask, “What does, ‘file a tax return’ mean?”

To file a tax return means to mail or otherwise transmit to an IRS Service Center the taxpayer’s information in a specified format, about income and tax liability.

Ask, “Does everyone need to file a tax return?”

Distribute copies of Student Handout 3.8, “Should You File a Tax Return?”

No, some people do not need to file a return. However, if they had federal income tax withheld from their paychecks, they should file a return to get their refund.

Have students work through the series of questions and answers to decide whether they, or someone in a hypothetical situation, should file a return.

To make sure students understand filing requirements, ask for a show of hands in response to such questions as, “How many of you are claimed as a dependent on the return of your parents or someone else?”

Students may need to review the definition of dependent by looking at Student Handouts 3.1, “Glossary of Key Terms,” and 3.4, “The Dependency Tests.”

Students claimed as dependents by someone else should look at question 1 on the upper half of Handout 3.8 and study the diagram underneath it.

“How many of you are not claimed as a dependent?”

Students who are not claimed as someone’s dependent should look at question 2 and the diagram on the lower half of Handout 3.8.

“How many of you are married?”

Students who are married should look at the question in the left hand box of the appropriate diagram.

“How many of you are not married?”

Students who are not married should look at the question in the right-hand box of the appropriate diagram.

2. Deciding Which Form To File

Ask, “Suppose you’ve decided that you need to file a tax return. What form do you use?”

Everyone who files a tax return uses some version of Form 1040. Besides the standard Form 1040, there are two easier versions, 1040A and 1040EZ. These are for people whose tax situations are relatively simple.

Distribute copies of Student Handout 3.9, “Which Tax Return Form Should You Use?”

Have the students look again at Student Handout 3.1, “Glossary of Key Terms.”

Call their attention to the definition of “Exemption (Personal or Dependency)” and make sure they understand the distinctions among this term, Exempt (from Withholding) and Withholding Allowance discussed earlier in Lesson 3. Exemption, as it is used on tax returns, is a set amount for each taxpayer and each eligible dependent that is subtracted from adjusted gross income to reduce the amount on which tax is figured.

Ask students, “Which form are most high school students likely to use?”

Unless they are married and have dependents or have considerable amounts of unearned income, most high school students will use Form 1040EZ.

Ask, “Which form would the chief executive of a large real estate corporation be most likely to use?”

Anyone with income from rent, buying and selling houses, or similar sources would need to use Form 1040.

3. Filling Out Form 1040EZ

Distribute copies of Student Handout 3.10 - forms 1040EZ; 3.11, Tax Table; and 3.12 Forms 1040EZ Step-by-Step.

Have the students fill out Form 1040EZ using either Student Handout 3.12 or the instructions on the back of Form 1040EZ. If they use both simultaneously, they may become confused. They will also need to use Student Handout 3.11, “Tax Table” for line 10.

You may want to display Form 1040EZ using an overhead projector. If you prefer that the students fill out the forms for someone fictitious rather than themselves, see alternative activity, below

In the “Income” section of the form, students will need to decide whether they can be claimed as a dependent by someone. Have them review Student Handout 3.4, “The Dependency Tests” if they are in doubt. Students must check “yes” on line 5 if someone can claim them as a dependent, whether or not that person actually does.

Hint for students using Student Handout 3.12 to keep from losing their place they should check off each step as they complete it.

If they can be claimed as a dependent, they will probably use the worksheet on the back of 1040EZ. They will probably want to know the meaning of \$700 printed on line B. (If they use Handout 3.12, they will be able to fill out Form 1040EZ without using the worksheet, but they won't understand where the figures come from.)

\$700 is the minimum standard deduction for a dependent. At line D, the 1999 maximum standard deduction is \$4,300 for single people and \$7,200 for married people filing a joint return. The worksheet shows that all dependents may deduct at least \$700 and no more than \$4,300, depending on how much they earned. Those who can be claimed as dependents of others cannot take an exemption for themselves because that exemption can be or is claimed by the other person.

Alternative or additional activity:

Distribute Student Handout 3.6, "Case Studies."

Have students fill out Form 1040EZ for Joseph Red, Case Study C.

1 class period:

day3

Ask students to look again at Student Handout 3.9, "Which Tax Return Form Should You Use?"

1040A and Beyond

Ask the students to look at the situations that make Form 1040A rather than Form 1040EZ the better choice for certain taxpayers.

Form 1040A should be used instead of Form 1040EZ if the taxpayer claims any dependents, has more than \$400 of interest and/or income from dividends, annuities, or certain other sources, and/or is entitled to certain income adjustments and credits. For situation beyond the scope of Form 1040A, taxpayers should use Form 1040.

Distribute copies of Student Handout 3.13, "Form 1040A," Student Handout 3.14, "Schedule 1, and Student Handout 3.15 Standard Deduction Worksheet for Dependents (Form 1040A Instructions).

Have the students look over Form 1040A. Call their attention to lines 7 through 14 in the section, "Income." Have the students look at line 8a, "Taxable interest." Point out that to fill out some of these lines, you have to fill out other forms or worksheets first. If your interest income is more than \$400, for example, you have to complete and attach Schedule 1, Part I.

On Form 1040A, there is space to report income from a variety of sources, including line 8b, "Tax-exempt interest"; line 9, "Ordinary dividends"; and line 10a, "Total IRA distributions." The worksheet for dependents allows for more situations than the equivalent worksheet on page 2 of Form 1040EZ.

(You may want to provide a copy of the 1040A instructions for students to examine. You can get it at your local IRS office, certain public libraries, or by calling 1-800-TAX-FORM)

Line 9 may require completion of Schedule 1, Part II. Lines 10b, 11b, 15 and 16 of Form 1040A refer taxpayers to the instructions. Tax Tables used to complete Forms 1040EZ and 1040A are in the instructions.

Point out that there are several places on Form 1040A where specific schedules are required for taxpayers to get special credits.

Students who might need more information about the credit for child and dependent care expenses, child tax credit, education credits, or the earned income credit should be directed to the instructions and the appropriate schedules and worksheets.

Line 26 provides for credits for child and dependent care expenses with completion of Schedule 2. Line 27 asks for Schedule 3 to figure the credit for elderly or disabled people. Line 28 is used to claim the child tax credit. Line 29 asks for Form 8863 to claim the education credits. Accurate completion of any of these could lower the taxes owed.

Distribute copies of Student Handout 3.16, "Form 1040A Step by Step," and Student Handout 3.11, "Tax Table," or use a projector to show them to the class.

Have the students use Handout 3.16 to fill out Form 1040A, either individually or as a class. In the latter case, you may want to demonstrate how to complete the form accurately by filling out the form you have projected or by talking through the steps aloud.

You may wish to have students use Student Handout 3.6, "Case Studies." Students can use the information in Case Study D to practice filling out Form 1040A instead of putting in information about themselves.

Students should check each item on Handout 3.16 as they complete each step of the process of filling out Form 1040A.

Concluding the Lesson

Distribute copies of Student Handout 3.17, “The Tax Maze.” Have students use any remaining class time to work the puzzle, or encourage them to take it home and try it.

Distribute copies of Student Handout 3.18, “Lesson Summary and 3.19 Answers -- The Tax Maze.” Make sure that any students who were absent from the lesson receive all the handouts.

Extending the Lesson (homework assignment)

Distribute copies of Student Handout 3.6 - Case Studies (if students don't already have them), two additional copies of each of Form W-4 and 1040EZ and one additional copy of the Tax Table.

Have the students complete Form W-4 for Case Study A (if they haven't already done it) and Forms 1040EZ for Case Studies B and C (if not yet done). If students are interested, also give them two copies of each Form 1040A, Schedule 1, and the Standard Deduction Worksheet for Dependents.